

STATE AND LOCAL GOVERNMENT SUBSIDIES FOR BUSINESSES: A SIREN'S TRAP

DALE A. OESTERLE*

When putting the material together for this presentation on state and local subsidies of local businesses, I read, over a very short period, four articles in the only major newspaper covering the state capital of Ohio, *The Columbus Dispatch*. First, the paper featured a front page article on the dismay in Columbus when a northern suburb “stole” the headquarters of Bob Evans Farms with a package of tax breaks and subsidies.¹ Second, the paper’s business section noted the lingering despair in Columbus over the collapse of a local airline business, Skybus Airlines. The State and Columbus had invested a substantial sum in the airline,² and the city was suing to claw back some of the lost revenue.³ Third, the paper noted the local excitement over the beginning of the shooting of a new comic book film that the State had bid to get.⁴ And fourth, the paper reported that a local Coda lithium-ion battery plant, plied with heavy state subsidies and

* J. Gilbert Reese Chair in Contract Law, The Ohio State University Moritz College of Law.

¹ Tracy Turner, *Hard-Boiled Choice: Bob Evans to Move Headquarters to New Albany*, THE COLUMBUS DISPATCH, Mar. 11, 2011, at A1 (“Despite a bounty of incentives offered by Columbus, the restaurant and food-manufacturing company announced yesterday that it is leaving the South Side [of Columbus] . . .”). See also Holly Zachariah, *Dublin City Council Incentives for Six Businesses on Agenda*, THE COLUMBUS DISPATCH, Jan. 10, 2011, at B1 (discussing Columbus suburb Dublin’s attempts to lure Alcatel-Lucent out of downtown Columbus); cf. Jennifer Nesbitt, *Westerville: Elmer’s Headquarters Will Move to Polaris Parkway*, THE COLUMBUS DISPATCH, Sept. 16, 2010, at B3 (describing how the Elmer’s glue company planned to move its headquarters from Columbus to the nearby suburb of Westerville, at least in part because the company would “be eligible for a five-year, 20 percent income-tax incentive . . .”).

² Marla Matzer Rose, *Taking Off Debt*, THE COLUMBUS DISPATCH, Mar. 27, 2011, at D1 (describing how nearly three years after the airline went bankrupt, city and state officials were recovering cash grants and tax waivers in bankruptcy proceedings).

³ *Id.*

⁴ Tim Feran, *Superhero Film Soaring Into Ohio*, THE COLUMBUS DISPATCH, Mar. 4, 2011, at A10 (discussing how the superhero film *The Avengers* was slated to be filmed in Ohio, which defeated Michigan in the bidding by offering a film tax-credit, despite criticism from an Ohio study predicting that the tax-credit will cost Ohio more money than films will bring in). See also *States Fighting For Filming*, ALLBUSINESS (2008), <http://www.allbusiness.com/print/14748636-1-22eeq.html>. For a similar business bidding war, see Mike Pramik, *Red Roof Returning to Roots in Columbus*, THE COLUMBUS DISPATCH, Nov. 29, 2007, at C10 (describing how both the state of Ohio and the city of Columbus combined to give Red Roof Inn nearly one million dollars in tax credits in order to lure its headquarters from Dallas, Texas).

visited by our President who delivered a speech on investment in alternative energy, would fail unless a federal grant of \$500 million backed up the state subsidies.⁵

This is but several weeks in a single local paper; such stories populate the newspapers and blogs of all our major cities.⁶ State and local governments routinely are shelling out huge subsidies to attract businesses. In Ohio, the state, facing severe budget problems, opened 2011 by loaning \$5.4 million to five companies.⁷ Estimates of all state and local subsidies in the country run to tens of billions a year.⁸ The grants and subsidies come in a variety of forms and are hard to cumulate and total. At the state level there are corporate income tax credits, enterprise zones, sales tax exemptions, cash grants, low-cost capital financing and loan guarantees, and reimbursement for worker training expenses.⁹

At the local level, often bundled with state grants, are property tax abatements, tax increment financing, sales tax rebates, infrastructure improvements, land parceling and land write-downs.¹⁰ Most states have very poor disclosure procedures to track where the subsidies go and there is little or no disclosure on the results.¹¹ A think tank interested in totaling

⁵ See Dan Gearino, *Coda's Slow Start Adds to Doubts*, THE COLUMBUS DISPATCH, Mar. 13, 2011, at A1 (noting how the Obama Administration's delay in approving the \$500 million to Coda "raises questions about Coda and its plan" to operate in Ohio).

⁶ See, e.g., Chris Christoff, *Snyder: Sweeping Cuts to Tax Breaks, Cities, Schools*, DETROIT FREE PRESS, Feb. 17, 2011, at A1 (describing how the governor of Michigan proposed deep cuts while lowering business taxes by \$1.8 billion); Christine Harbin, *Missouri Spends Billions Propping up Private Industries*, SHOW-ME DAILY (Feb. 14, 2011, 5:36 PM), <http://www.showmedaily.org/2011/02/missouri-spends-billions.html>; Kent Hoover, *States Spend Big in Feverish Biotech Pursuit*, MSNBC.COM (Oct. 3, 2005, 4:37 PM), http://www.msnbc.msn.com/id/9580014/ns/business-local_business (noting how Florida put together a \$500 million package to get the Scripps Institute to start up a branch in the state, as well as similar efforts in Arizona, North Carolina and Alabama).

⁷ *Ohio Investments to Spur Economic Growth with More Than \$5.4 Million in Project Loans*, MFRTECH.COM (Jan. 31, 2011, 6:39 PM), <http://www.mfrtech.com/articles/9812.html>.

⁸ Philip Mattera, et al., *Show us the Subsidies: An Evaluation of State Government Online Disclosure of Economic Development Subsidies*, GOOD JOBS FIRST (Dec. 2010), <http://www.goodjobsfirst.org/sites/default/files/docs/pdf/showusthesubsidiessrpt.pdf> (citing decade-old estimates putting the number at \$50 billion a year, including KENNETH THOMAS, *COMPETING FOR CAPITAL: EUROPE AND NORTH AMERICA IN A GLOBAL ERA* (2000); Peter Fisher & Alan Peters, *The Failures of Economic Development Incentives*, J. AM. PLAN. ASS'N (Winter 2004)).

⁹ *Id.* at 1.

¹⁰ *Id.* at 2.

¹¹ See *id.* at 13. See also Steven Greenhouse, *Are Job Subsidies in Your State Working?*, N.Y. TIMES ECONOMIX BLOG (Dec. 9, 2010, 9:20 AM), <http://economix.blogs.nytimes.com/2010/12/09/are-job-subsidies-in-your-state-working/>.

state subsidies eventually gave up and decided to fall back on a study that just rated the quality of State disclosure. The State of Ohio rates a C+.¹²

A serious question is whether the state and local subsidies do benefit local economies. Are the subsidies a waste of taxpayer dollars?

As with most politically tinged questions the answer depends on whom you ask. If you ask members of the business community, even those who claim to be rugged capitalists, they will sing the praises of such subsidies and grants. "We could not start up these valuable and special businesses without such help" An example is the aforementioned company, Coda: its former CEO—an entrepreneur who worked for Goldman Sachs before heading up Coda¹³—sought loans from the federal government to start up a plant in Ohio.¹⁴ This is true of established businesses as well: Panasonic executives recently noted they would not have been able to remain in New Jersey without a huge tax break from the state.¹⁵

If you ask the politicians who make the decisions to subsidize, even those who are libertarian free traders, they will defend the decisions as self-obvious. "We are creating new jobs, directly and indirectly, and the taxes on those new jobs will more than repay any subsidies or grants" An example of this is Ohio governor John Kasich, a conservative Republican who criticized these kinds of subsidies as a member of the U.S. House of Representatives. Upon becoming Ohio governor in 2011, he offered \$93.5 million in credits and grants to keep the American Greetings Company in Ohio and \$20.9 million to keep Bob Evans in the state.¹⁶ Another example in Ohio was a proposal by then-State Senator Jon Husted, another conservative Republican—who is now Ohio's Secretary of State—to use \$31 million in tax credits to attract new business to Dayton, Ohio, following the departure of NCR's corporate headquarters from the city.¹⁷ The behavior is typical among Democrats as well, of course, even those who are decidedly anti-big business. For example, late in 2010, the Democratic U.S. Senator from Ohio, Sherrod Brown, and then-governor Ted Strickland, also

¹² Mattera, *supra* note 8, at 13. In a sad commentary on just how poor states are at this kind of disclosure, Ohio's C+ was enough to make it the 4th best state in America for business subsidy disclosure. *Id.*

¹³ See Jim Motavalli, *In Surprise Move, Coda's Chief Executive Resigns*, N.Y. TIMES WHEELS BLOG (Nov. 8, 2010, 3:53 PM), <http://wheels.blogs.nytimes.com/2010/11/08/in-surprise-move-codas-chief-executive-resigns/>.

¹⁴ See Dan Gearino, *Electric-car maker says it's fully American*, THE COLUMBUS DISPATCH, Oct. 29, 2010, at A10.

¹⁵ Mark Niquette, *States Use Tax Breaks in War for Jobs*, BLOOMBERG BUSINESSWEEK (May 4, 2011, 11:13 PM), http://www.businessweek.com/magazine/content/11_20/b4228029534552.htm?campaign_id=yhoo. New Jersey offered Panasonic a \$102.4 million tax credit to keep its North American headquarters in New Jersey. *Id.*

¹⁶ *Id.*

¹⁷ William Hershey, *Husted Seeking Ideas to Help Area Rebound*, DAYTON DAILY NEWS, June 3, 2009, at A4.

a Democrat, lobbied the federal government for millions in loans to entice a pair of new businesses to open in Ohio.¹⁸ The duo claimed that these loans would create over a thousand jobs in the state.¹⁹

The claim of politicians is familiar and often repeated: the subsidies are creating jobs, improving the state economy and will be repaid in higher tax revenues from the new jobs and businesses. A more skeptical view would emphasize that politicians are acting on short-term incentives to reward local constituents or to attract votes.²⁰ Skeptics also note that the state subsidy bandwagon supports its own merry-go round industry of lobbyists, out of office politicians, and their staffs. Ohio once again provides a perfect example. Ohio enacted the Third Frontier program, which through the beginning of 2010 had pumped \$500 million into Ohio businesses.²¹ On May 4, 2010, voters were asked whether or not to put \$700 million more into the program.²² Lining up behind the proposal was “[a] legion of elected leaders, development pros and businesspeople.”²³ Lobbying for the proposal were “[e]very major chamber of commerce in Ohio . . . as [well as] the Ohio Farm Bureau, the voice of Ohio’s powerful agriculture industry.”²⁴ Ohio universities, including Case Western Reserve University and Cleveland State University, had received funds either themselves or through related entities.²⁵ Thus, a major lobbying effort was underway to keep the money flowing by business leaders, lobbying groups—like the chambers of commerce—and universities, eager to keep riding the gravy train.

Voters overwhelmingly approved the additional \$700 million, with 62% voting in favor of the proposal.²⁶ The lobbying effort was not merely a one-off tied to that specific vote, however. After all, those funds have to go somewhere, and thus, the scene of the lobbying effort moved to the Ohio

¹⁸ Jonathan Riskind & Dan Gearino, *Brown, Strickland Lobby for Big Projects*, THE COLUMBUS DISPATCH, Sept. 16, 2010, at A10.

¹⁹ *Id.*

²⁰ See JAMES M. BUCHANAN & RICHARD E. WAGNER, DEMOCRACY IN DEFICIT 48–50, 96–98 (1977). Buchanan and Wagner noted that these policies are controlled . . . by politicians engaged in a continuing competition for office Political decisions in the United States are made by elected politicians, who respond to the desires of voters and the ensconced bureaucracy. There is no center of power where an enlightened few can effectively isolate themselves from constituency pressures.

Id. at 96.

²¹ Tom Breckenridge, *Partisans Aim to Raise Program’s Profile*, THE PLAIN DEALER (Cleveland), Apr. 11, 2010, at A10.

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Ohio Antes Up*, THE PLAIN DEALER (Cleveland), May 6, 2010, at A9.

Third Frontier Commission, the body in charge of allocating the funds.²⁷ Funds go to both individual companies and to universities like the aforementioned Case Western Reserve and The Ohio State University.²⁸ Third Frontier is not only subsidizing business and university programs, but it is helping subsidize the individuals and groups who lobby as to where the funds will be allocated as well.

Historically, a small but vocal community of skeptics (labeled “spoilsports” and political “losers”) has made a parade of now familiar arguments against the government subsidies. The companies, they argue, do not need the subsidies to prosper, play off states and locales against each other, do not create the promised jobs or that the jobs created are of poor quality, are granted an unfair advantage over existing companies that do not get subsidies (unless they threaten to move), and are draining governments of revenues that force cutbacks in vital public services.²⁹ But again, historically these arguments have not deterred our headlong rush to invest government money in local businesses.

Economists, however, are the new class of doubters.³⁰ Most sensible economists note that the answer depends on the elusive quest for a substantially positive “Keynesian Multiplier”³¹ from each government dollar invested. The theoretical economists group into a long-running, traditional divide between the Keynesians, who support the subsidies, and the Monetarists, led by Milton Friedman,³² the Neo-classicists,³³ and the

²⁷ See *Third Frontier OKs \$14M for Alternative Energy Industries, Including Dublin's Adsorption Research*, BUSINESS FIRST (Jan. 28, 2011 11:11 AM), <http://www.bizjournals.com/columbus/news/2011/01/28/third-frontier-oks-14m-for-energy.html>.

²⁸ See *id.*

²⁹ See, e.g., Scott Suttel, *Ohio is Among the Leaders in Corporate Largess*, CRAIN'S CLEVELAND BUSINESS (May 5, 2011, 12:18 PM), <http://www.crainscleveland.com/article/20110505/BLOGS03/110509906>. This entry quotes Jon Shure of the Center on Budget and Policy Priorities as saying that states pay for these subsidies by “cutting other areas that really are the building blocks of jobs and economic growth.” *Id.* In the same entry, Ohio governor John Kasich is quoted despairing about how subsidies have turned into a competition states have no choice but to engage in. *Id.* Finally, Greg LeRoy of Good Jobs First is quoted as explaining that there is currently no way to do an effective cost-benefit analysis of these subsidies. *Id.* See also Greg LeRoy, *The Relocation Racket: How Relocation Consultants Pit Cities and States Against Each Other*, MULTINATIONAL MONITOR, Sept.–Oct. 2006, 19–21; Richard M. Vogel, *Relocation Subsidies: Regional Growth Policy or Corporate Welfare?*, 32 REV. RADICAL POL. ECON. 437, 438 (2000) (noting that “subsidies have traditionally been viewed with skepticism by economists . . .”).

³⁰ Cf. Vogel, *supra* note 29, at 438.

³¹ See, e.g., James C.W. Ahlkapor, *On the Mythology of the Keynesian Multiplier*, AM. J.ECON.SOC. 745–773 (2001) (discussing the Keynesian Multiplier).

³² See, e.g., MILTON FRIEDMAN & ANNA JACOBSON SCHWARTZ, *A MONETARY HISTORY OF THE UNITED STATES 1867–1960* (1963).

³³ See, e.g., E. Roy Weintraub, *Neoclassical Economics*, in THE CONCISE ENCYCLOPEDIA OF ECONOMICS (David R. Henderson ed., 1st ed.) available at

Austrians, led by F.A. Hayek,³⁴ who do not. The reasons for the disagreement vary depending on the economic school of thought. The Monetarists view monetary policy—controlling interest rates—as the key role of government in the market.³⁵ The Neoclassicists focus on the importance of individual economic decisions;³⁶ the Austrians focus on free markets, markets for goods and services not dominated by government direction and control.³⁷ In each of the anti-Keynesian theories government efforts to stimulate markets do more to distort the economy than to improve it.

But it is the modern empirical economists who are the real wet blankets. The best recent studies, particularly those of Professor Robert J. Barro of Harvard, have found that the vast majority of government subsidies and grants do not, in fact, provide a Keynesian multiplier of 1.0 or more—a necessary justification for even the most ardent Keynesian advocates.³⁸ The result of failure is heavy: government subsidies and grants that do not result in a sufficiently high multiplier are economically injurious to the state or local government that has granted them. The subsidies and grants are, in short, a local economic disaster.

The evidence discovered by Professor Barro is new and deserves a broad distribution and careful evaluation. If the conclusions of his study hold up, there should be a very heavy—almost conclusive—presumption against state and local government subsidies for businesses, large and small.

To understand Professor Barro's work, one must first look to the Keynesian principals he is testing. In one of the seminal works of macro-economics, *General Theory of Employment, Interest and Money*, John M. Keynes argued that government spending is a useful tool for increasing and

<http://www.econlib.org/library/Enc1/NeoclassicalEconomics.html> (last visited Sept. 25, 2011).

³⁴ See, e.g., Peter J. Boettke, *Austrian School of Economics*, in THE CONCISE ENCYCLOPEDIA OF ECONOMICS (David R. Henderson ed., 1st ed.), available at <http://www.econlib.org/library/Enc/AustrianSchoolofEconomics.html> (last visited Sept. 25, 2011).

³⁵ See Bennett T. McCallum, *Monetarism*, in THE CONCISE ENCYCLOPEDIA OF ECONOMICS (David R. Henderson ed., 2nd ed.), available at <http://www.econlib.org/library/Enc/Monetarism.html> (last visited Sept. 25, 2011).

³⁶ See Weintraub, *supra* note 33.

³⁷ See Boettke, *supra* note 34.

³⁸ See, e.g., Robert J. Barro & Charles J. Redlick, *Stimulus Spending Doesn't Work*, WALL ST. J., Oct. 1, 2009, at A24. (Barro argues that “[t]he available empirical evidence does not support the idea that spending multipliers typically exceed one, and thus spending stimulus programs will likely raise the GDP by less than the increase in government spending.”). See generally Robert J. Barro, *Voodoo Multipliers*, THE ECONOMISTS' VOICE (Feb. 2009), http://www.economics.harvard.edu/faculty/barro/files/09_02_VoodooMultipliers_EconomistsVoice.pdf (Barro's studies look at subsidies by the federal government, but his reasoning and conclusions are applicable to subsidies issued by state and local governments as well).

stimulating employment rates.³⁹ The idea is particularly appealing during economic recessions: increase government spending, even if the government has to borrow the money, to increase economic activity and jobs.⁴⁰ In theory, Keynesians argue that as the government injects money into the economy, private entities and individuals have more money to spend, aggregate demand increases and the higher aggregate demand incentivizes private entities to produce more and hire more to increase production. Government spending creates a cascade effect, a multiplier, as the immediate boost to employment and output itself produces a second, third, fourth and beyond level ripple effect on employment and output. The total impact of any government expenditure stimulus is the sum of all these separate output ripples. The ratio of the initial government expenditure to the total impact, the sum of the ripples, is called the "Keynesian Multiplier" or the "Spending Multiplier."⁴¹

Traditional theory holds that government spending is a success if the Keynesian Multiplier is over 1.0. A government should spend a dollar only if it can expect to increase gross domestic product (GDP), or some other index of national production, by more than one dollar.⁴² A failure under traditional theory is any government expenditure in which the multiplier is under 1.0, the GDP increases by less than a dollar for every dollar spent by the government.

The traditional view of a successful multiplier seems to set an unacceptably low bar. Ask a simple question: Why does a multiplier of 1.0 work when new taxes cannot repay the new government debt? An increase of GDP of one dollar produces around twenty-five cents in increased federal tax revenue.⁴³ Moreover, government is spending now and receiving taxes from increased GDP in the future; the government must borrow

³⁹ *Voodoo Economics, Part I: The Keynesian Multiplier Demystified*, MOVELEFT.ORG, http://moveleft.org/voodoo_multiplier/index.html (last visited Sept. 25, 2011).

⁴⁰ *See id.*

⁴¹ *See id.* *See also* Gary Becker, *Fiscal Stimulus Packages: What Are Their Effects?*, UNIV. CHI.: THE BECKER-POSNER BLOG (Mar. 1, 2010), <http://www.becker-posner-blog.com/2010/03/fiscal-stimulus-packages-what-are-their-effects-becker.html>.

⁴² *See* Robert J. Barro, *Government Spending is No Free Lunch*, WALL ST. J., Jan. 22, 2009, at A17 (explaining that if the multiplier is 1.0, then government spending would lead to a one-unit increase in GDP and reporting that the Obama administration viewed the multiplier on its stimulus spending as being close to 1.5).

⁴³ *See Revenue Statistics-Comparative Tables*, OECD, <http://stats.oecd.org/Index.aspx?DataSetCode=REV> (last visited Sept. 25, 2011). In 2008, total federal tax revenue as a percentage of GDP was 26.1% according to the OECD; in 2009 the number was 24%. *Id.* The Heritage Foundation estimated the revenue as a percentage of GDP to be a bit higher in 2010, at 26.9%. *2011 Index of Economic Freedom: United States*, THE HERITAGE FOUND., <http://www.heritage.org/index/Country/UnitedStates> (last visited Sept. 25, 2011). Thus, if total federal tax revenue is approximately 25% of GDP, we would expect to get a twenty-five cent increase in federal tax revenue for every dollar increase in GDP.

money and pay interest. Using tax-based calculations, governments need a spending multiplier of well over 4.0 to stay solvent; spend one borrowed dollar now and reap one tax dollar plus some to cover the interest in exchange.⁴⁴ In real dollars one should demand a multiplier that is higher than 4.0 to repay the debt and its interest. Again, why should we ask politicians to spend whenever they can predict a multiplier in excess of only 1.0?

The tax revenue situation is even stickier for state and local governments. An increase in state GDP will return less than ten percent in state and local tax revenue.⁴⁵ State and local governments then, in theory, would need a huge multiplier of 10.0, or perhaps much higher, on government stimulus expenditures to return enough tax dollars to pay for the stimulus payment. This, of course, is next to impossible.

When I ask macro-economists about the tax revenue conundrum, many are baffled. Most say the economy will continue to grow and produce the necessary tax revenue. This presents a definitional problem: either the multiplier includes all the GDP “ripples” or it does not. If the multiplier does include all economic ripples to aggregate demand, the core definition used in Keynesian theory, then the argument is a *non sequitur*. I have yet to find a satisfactory answer.

Some macro-economists’ answer is, as I understand it, that when the economy grows in the long run, inflation (because the economy is later in the “business cycle”) will cause the government to collect inflated tax revenues that it can use to pay pre-inflation debt. The answer depends on a hidden higher future tax on taxpayers, due to inflation. It is hard to imagine and expect the magnitude of inflation necessary to rebalance the budget (300%), so again I am perplexed. Moreover, the economists cannot predict with any level of certainty future inflation, which means they cannot predict whether a multiplier for federal spending of 1.0 or 2.0 or even 3.0 is necessary given the anticipated inflation. The inflation depends, among other things, on the percentage of foreign to domestic borrowing on the new

⁴⁴ This is an inference drawn from a 25% rate of return for every dollar spent. The multiplier would change (higher or lower) depending on the total federal tax revenue as a percentage of GDP, but this is a good rule of thumb: if the total tax revenue is around 25% of GDP, a multiplier of 1.0 would yield a return of twenty-five cents for every dollar increase. Thus to recoup each dollar spent to stimulate the economy, the multiplier would need to be 4.0.

⁴⁵ According to Census Bureau statistics, Vermont takes in the most tax revenue per dollar of GDP, getting eighty cents of revenue for every ten dollars of GDP. Some states are as low as thirty-five cents for every ten dollars of GDP. *Total Tax Burden (Per \$ GDP) (most recent) by State*, STATEMASTER.COM, http://www.statemaster.com/graph/eco_tol_tax_bur_percgdp-total-tax-burden-per-gdp (last visited Sept. 25, 2011).

debt.⁴⁶ The answer is not very satisfactory and one wonders what a true multiplier goal for federal stimulus grants should be—less than 4.0 perhaps but surely much higher than 1.0. I would submit that absent other evidence we ask our politicians to predict a multiplier of over 3.0 before they make a stimulus-justified expenditure.

Recently, both President Bush and President Obama acted on the Keynesian theory, encouraging Congress to pass and then sign large stimulus bills. Bush injected \$152 billion into the economy and Obama injected \$787 billion.⁴⁷ Nearly every government in Europe and Asia and other governments in North America have followed, also passing large government stimulus packages in the recent past.⁴⁸ State and local government subsidies, which have a long and less episodic pedigree, are but another example of government officials believing in the Keynesian multiplier.

Even though the theory of Keynes dates back to the Great Depression, scholars have only recently produced studies that credibly estimate spending multipliers from government spending. Many other economic variables change whenever government-spending levels change. Empirical economists have found it very difficult to isolate the pure effects of government spending given the noise in the data caused by other economic changes.⁴⁹ Some of the other economic variables include changing prices, wages, interest rates, consumption levels, and private investment amounts.⁵⁰ Theorists therefore have been left to the field of debate and debate they do, claiming to rank multipliers on improvements to infrastructure, education, health and technology over raw business subsidies.⁵¹ Politicians have

⁴⁶ Domestic borrowing just “crowds out” domestic investment spending that otherwise would occur. But, in the long run, foreign borrowing affects transfers of national wealth.

⁴⁷ J.D. Foster, *Keynesian Fiscal Stimulus Policies Stimulate Debt—Not the Economy*, THE HERITAGE FOUND. (July 27, 2009), <http://www.heritage.org/research/reports/2009/07/keynesian-fiscal-stimulus-policies-stimulate-debt-not-the-economy>.

⁴⁸ *Id.*

⁴⁹ Cf. Daniel Fisher, *Keynes Who?*, FORBES.COM (Aug. 9, 2010, 12:00 AM), <http://www.forbes.com/global/2010/0809/ideas-paul-krugman-robert-barro-stimulus-double-dip-debate.html>. Robert Barro argues that a connection between government spending cuts and a collapse in industrial production during the Great Depression is “illusory,” because finding a connection there ignores other factors like bank reserve requirement increases and a number of new labor union contracts. Furthermore, much state and local spending is determined based on economic conditions. Thus, “[t]o attribute the rise and fall of the economy to their spending puts the relationship backward.” *Id.*

⁵⁰ See, e.g., Barro, *supra* note 38.

⁵¹ See, e.g., *Economic Stimulus for Small Business: A Look Back and Assessing a Need for Additional Relief: Hearing Before the H. Comm. on Small Bus.*, 109th Cong. (2008) (statement of Mark Zandi, Chief Economist, Moody's Analytics) (recommending a gas holiday, expansion of the food stamp program, a payroll tax holiday, aid to state governments, extension of investment tax incentives, and

enjoyed the latitude from the uncertainty in the theory to favor pet projects, both to meet ideological programs and to reward local constituents.

What general evidence there is has suggested that most government spending projects produce a multiplier of less than 1.0.⁵² Thus one does not have to worry about the tax revenue repayment problem. One year after President Obama's stimulus passed, most agreed that the stimulus bill has not produced its expected multiplier.⁵³ Very committed Keynesians are left to argue that the government took too long to spend the money or that the government was too timid and should have spent three times what it did.⁵⁴ The Monetarists and others that oppose Keynesians simply argue that the multiplier is a myth⁵⁵ and that our current experience is further proof of their position.⁵⁶ Their two main arguments are, one, that politicians cannot choose high value projects⁵⁷ and, two, that government borrowing to produce the higher spending levels "crowds out" private investment in the private sector⁵⁸ as private investors anticipate future taxes.⁵⁹ Others also

increased infrastructure spending. Zandi listed estimated multipliers for a variety of options. He believed that temporarily increasing food stamps provided the highest multiplier of 1.73. His calculation of the increased infrastructure spending multiplier was 1.59). *But see*, Ronald G. Bodkin, *Review of Otto Eckstein's The DRI Model of the U.S. Econ.*, 51 S. ECON. J. 1253 (1985) (traditional, "textbook" theory overestimates multipliers).

⁵² See, e.g., Barro, *supra* note 38 (arguing that the multiplier during World War II, a time of massive government spending, was only 0.8). See also Barro and Redlick, *supra* note 38.

⁵³ Robert J. Barro, *The Stimulus Evidence One Year On*, WALL ST. J., Feb. 23, 2010, at A19.

⁵⁴ See, e.g., Fisher, *supra* note 49 (quoting economist Paul Krugman arguing that "the real problem is inadequate spending" by the government).

⁵⁵ See, e.g., John F. Cogan et al., *New Keynesian Versus Old Keynesian Gov't Spending Multipliers*, J. ECON. DYNAMICS & CONTROL 281–282 (2010) (arguing that a study by Christina Romer and David Bernstein stating that the Obama stimulus would have a multiplier above 1.0 "fail[s] a simple robustness test." For those who do not speak "academic" this translates into something close to a statement that the Romer and Bernstein paper is junk science). *But see* Jesper Linde, Member, Fed. Res. Bd., Address at CQER Conference on New Approaches to Fiscal Policy: Discussion of New Keynesian Versus Old Keynesian Gov't Spending Multipliers (Jan. 8–9, 2010), available at https://www.frbatlanta.org/documents/news/conferences/10fiscal_policy_linde_discussion.pdf (last visited Sept. 25, 2011) (stating that even New Keynesian models predict high multipliers for "well-timed moderate increases in government spending.").

⁵⁶ See, e.g., *supra* notes 32–39 and accompanying text.

⁵⁷ See, e.g., Becker, *supra* note 41 (noting that many of the stimulus projects were based on the whims of "liberal members of the Democratic controlled Congress," rather than "on sectors that had suffered large increases in unemployment, such as construction").

⁵⁸ See, e.g., Colin Hanna et al., *Rescind Obama's Remaining 'Stimulus'*, THE HILL (Feb. 14, 2011, 8:39 PM), <http://thehill.com/opinion/op-ed/144021-rescind-obamas-remaining-stimulus>.

⁵⁹ See Fisher, *supra* note 49.

argue that any price increase caused by government spending is inevitably inflationary, a hidden tax on private output.⁶⁰

As mentioned, Professor Barro has materially advanced our meager resources of empirical data and has taken, for a moment, the field from the theorists. Professor Barro has been crunching numbers to estimate both spending and tax multipliers from past recessions and found a method of isolating the spending results for a specific category of expenditures. The Professor has found that he can isolate the effects of spending multipliers for defense spending before, during and after wars, such as World War II and the Korean War.⁶¹ He has published his results in a series of editorials in the Wall Street Journal and other papers. His results so far are sobering. Multipliers from defense spending, long thought to be one of the most effective, high-spending multiplier forms of government spending, are a meager 0.4 to 0.6.⁶² The multiplier is well below 1.0 and the total effect on GDP is effectively negative.⁶³ Not only is the government not receiving a dollar in tax revenue for a dollar of defense spending, but the government is not growing the economy by a dollar for a dollar of spending. This is stunning data. He also notes that the spending multiplier for tax increases is negative.⁶⁴

Professor Barro thus argues that we should be very wary of Keynesian multiplier-based arguments for government spending. He projects that based on his study, President Obama's stimulus program will have a small,

⁶⁰ See George Melloan, *Why 'Stimulus' Will Mean Inflation*, THE WALL ST. J., Feb. 6, 2009, at A13.

⁶¹ See, e.g., Friedman & Schwartz, *supra* note 32. Budgets have to be balanced eventually and tax revenue decreases from tax rate decreases can force more borrowing, which crowds out private investment, and forces eventual tax rate increases. There is no silver bullet in tax revenue decreases without spending decreases. For those who admire the tax break portion of Obama's stimulus bill there is better news when one looks at the effect of tax increases: in Barro's calculations of tax multipliers the ratio of increase in national GDP to tax increases (including inflation) is -1.1. *Id.* Increases in marginal tax rates that raise tax revenue by \$300 billion, for example, will lower GDP by over \$300 billion in the following year. *Id.*

⁶² See, e.g., Barro, *supra* note 42. The defense-spending multiplier with an unemployment rate of 5.6% is 0.6 to 0.7 according to annual data starting in 1939. See Barro and Redlick, *supra* note 32.

⁶³ See Barro, *supra* note 42. There are dissenters from his findings. Most argue that linear time series models, like Barro's, understate the effect of spending in specific circumstances. See Miguel Almunia, Agustin S. Benetrix, Barry Eichengreen, Kevin H.O'Rourke, & Gisela Rua, *The Effectiveness of Fiscal and Monetary Stimulus in Depressions*, VOX (Nov. 18, 2009), <http://www.voxeu.org/index.php?q=node/4227> (fiscal stimulus effective in the Great Depression); Alan J. Auerbach & Yriy Gorodnichenki, *Measuring the Output Responses to Fiscal Policy* (Nat'l Bureau of Econ. Research, Working Paper 16311, 2010) (multiplier size is tied to position in business cycle).

⁶⁴ See *Voodoo Economics, Part I: The Keynesian Multiplier Demystified*, *supra* note 39 and accompanying text.

possibly even negative, overall effect on GDP.⁶⁵ To put his results in layman's terms, there should be a very heavy—almost conclusive—presumption that government spending, designed to stimulate the economy and nothing more (excluding expenditures for national defense, humanitarian goals or public infrastructure),⁶⁶ is not only a waste of taxpayer money, but is also harmful to our economic health. This suggests that any government, federal, state, or local, that is attempting to spend money to stimulate the economy should be put to a very heavy burden of justification. The public should not tolerate any stimulus expenditure without with a credible public presentation by sponsoring politicians of a calculation of an expected multiplier of 4.0 or more. This, of course, would be a radical change in direction for governments at every level in the United States.

My conclusion from all of this is that politicians and business leaders are pulling a “fast one” on the rest of us with their heavy public lobbying for government expenditures to “create jobs.” And the politicians and the business leaders are in cahoots; politicians want to spend government money to cement voter and funding allegiances, while business people want to receive the government largess to enjoy free investment funds. The alliance of public and private actors fundamentally injuring state and local economies when it is successful in hoodwinking the public into going along—usually with false promises of new local jobs (and occasionally lower personal tax rates). This is a slimy business. We should put a heavy burden of proof on concrete multiplier effects for each and every government business subsidy and hold politicians accountable when subsidies fail.⁶⁷ I would love to claw back some of their public salary if subsidies fail.⁶⁸ At minimum, through government accounting offices and

⁶⁵ See Barro, *supra* note 42. Barro argues that spending of \$300 billion in 2009 would result in a GDP increase of \$120 billion, while the same level of spending in 2010 would lead to a GDP increase of \$180 billion. *Id.* However, Barro argues that the government spending will reduce other areas of GDP, like personal consumption, investments by private individuals and exports. *Id.*

⁶⁶ See, e.g., Allison Manning, *New I-71 Exit Could Open Growth Spigot*, THE COLUMBUS DISPATCH, May 24, 2011, at 1B (describing how a new interchange on Interstate 71 could lead to \$965 million in economic growth for Delaware County, Ohio).

⁶⁷ Unfortunately, it may be difficult to hold politicians accountable through the judicial system. While the issue is beyond the scope of this article, there is some question as to whether citizens have standing to sue. See Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 405–18 (1996) (noting that businesses have standing but rarely sue and that citizens may lack standing, particularly in federal court, although some states have found that taxpayers have standing).

⁶⁸ Private business leaders are subject to clawbacks under Sarbanes-Oxley legislation if they were in office during a period of time when the company had to restate its accounting records. “If an issuer is required to prepare an accounting restatement . . . the chief executive officer and chief financial officer shall reimburse the [company] for” any bonuses in the year before an SEC filing

inspectors general, we should demand more transparency on where all state and local business subsidies go and on what effects those subsidies have had. We can no longer afford the luxury of this political equivalent of the "sirens' song."⁶⁹ We need to fashion a political version of tying Odysseus to the mast.⁷⁰

acknowledge a restatement is needed and from any profits stemming from a sale of securities in the company during that same period." 15 U.S.C. § 7243(a) (2006).

⁶⁹ HOMER, THE ODYSSEY 303 (WILLIAM CULLEN BRYANT trans., 1871).

Thou wilt first come to where the Sirens haunt. They throw a
spell O'er all who pass that way Hear the music, if thou wilt,
But let thy people bind thee, hand and foot, To the good ship,
upright against the mast, And round it wind the cord, that thou
mayst hear, The ravishing notes. But shouldst thou then entreat
Thy men, commanding them to set thee free, Let them be
charged to bind thee yet more fast with added bands.

Id.

⁷⁰ A political solution is necessary because the courts will be of little help even if citizens have standing to sue (*see supra*, note 67 for a discussion of the standing issue). *Cuno v. DaimlerChrysler, Inc.*, 386 F.3d 738 (6th Cir. 2004) provides a stunning example. In that case, the United States Court of Appeals for the Sixth Circuit held that tax incentives for business are constitutional unless the state is acting in a coercive manner. *See id.* In other words, if the state government attaches strings to try and increase accountability, the tax incentive will be found unconstitutional. *See Veena Iyer, Cuno v. DaimlerChrysler, Inc.: Dormant Commerce Clause Limits State Tax Location Incentives*, 40 HARV. C.R.-C.L. L. REV. 523, 537 (2005). This has the perverse effect of rendering attempts to make businesses who accept incentives more accountable to the taxpayers unconstitutional based on the Commerce Clause, while allowing incentives that provide no accountability. Therefore, we as citizens will only be able to hold politicians and businesses accountable through the political process.

